A Substitute for the Aldrich Plan

SEPARATE RESERVE ASSOCIATIONS

Preventive of Financial Panics
and
Suitable to American Conditions

BY
J. HOWARD COWPERTHWAIT
Author of
Money, Silver and Finance
(1892-1896)

The Trade Supplied by
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No statement of the financial problem would be complete without specifications of our lack of a supply of new money and new credit in time of need, and also our lack of an open discount market for financial and commercial paper at all times. And any good plan of financial reform must give due consideration to the need for establishing an open and broad discount market as well as to the building and filling of reservoirs of new money and new credit. In England, the discount market works so well in connection with the Bank of England that the reservoir of new money has not been tapped in half a century; and, to-day, the volume of paper money in England remains as fixed by the Act of 1844, that is at less than the equivalent of $100,000,000, excepting only such paper money as has the nature of gold certificates, the growth of British trade and industry having had to depend upon the importations of gold and upon the development of credit. And as it can not be disputed that the development of credit proceeds most generously in an open discount market where endorsed notes and accepted drafts are sold and resold over and over again, it should be worth our while to ascertain why we have no such market in this country. It may not be out of place to add that interest rates usually are lower in England than in America in spite of our superabundant issues of paper money and our almost twice as great circulation of money per capita.

SEPARATE RESERVE ASSOCIATIONS

There is a fundamental difference between American and foreign business customs, including English, and this difference gives a different character to the commercial paper created on the opposite sides of the Atlantic. Abroad, merchants buy goods on credit and give an acceptance on time-drafts, to cover the bill of sale, or get bankers to accept for them, thus creating "prime bills" of exchange. These bills, originating in certain mercantile transactions, with two names on them, the drawer and the acceptor and sometimes getting many names, are considered suitable for the investment of any idle funds, and when approaching maturity these bills become very choice for temporary investments. The discount market is so broad that nobody in buying such bills need fear that he may not be able to sell them should he, himself, be in need of funds before the bills mature. Here, on the contrary, the general custom with exceptions in a few lines or in country districts is to buy goods for cash, less a cash discount. The buyer provides himself with the necessary funds by selling his note through a broker or by getting his own bank to discount it; the note, in either case, being more suitable for its new owner to hold until its maturity than to resell, for to attempt to resell the note is possibly to excite suspicion of its value, or, maybe, to excite distrust of the strength of the bank which tries to resell. When banks resell paper, the transactions, as a rule, are in small circles among institutions habitually working together. It will be noticed, too, that while American commercial paper is supposed to arise from the need of manufacturers and merchants to ob-

tain funds to pay for merchandise, yet each piece of paper has not on its face the evidence of such use of the funds. Our kind of paper, when made in Europe, is avoided by bankers because of its possible financial character, as distinct from the desirable commercial character. But however advantageous to the further development of American industry and commerce, might be the changing of the quality of our paper so as to give it a better chance to become easily salable and re-salable, it must be admitted that American business methods are not at all likely to be changed and therefore that American paper will continue to be drawn somewhat as at present. The cash discount which a buyer deducts, in paying for goods, is generally twice as great as his loss of interest upon his own note, which he sells or puts through his own bank, and so the buyer will continue to pay cash. On the other hand, sellers who are in the habit of getting cash for their goods, less a cash discount, neither could nor would insist upon being given notes or acceptances instead of cash. We must therefore consider the possibility of the development of an open discount market for paper, any piece of which may or may not have arisen directly from a commercial transaction; and, certainly the prospect is not bright and may be spoiled by mistakes. Senator Aldrich proposes to confer upon national banks the right to accept time-drafts arising from commercial transactions, but as neither drafts nor notes arise in great volume **directly** from commercial transactions, it would seem to be better to say **directly or indirectly,** allowing both qualities of paper, or better still to limit the total

sum to be risked by any bank, in any one direction, and, say nothing about the quality of the paper to be accepted or to be endorsed. In England, there is little or no restriction upon bank action in such a matter as this, and I think that in the future we will control banks less by law and more by public opinion, exercised through clearing house associations or reserve associations. Of course, however, we are not going to lose sight of the fact that banks use the money which belongs to their depositors and, therefore, that there must be some adequate supervision.

It is not easy to over-estimate the importance of inducing the general lodgment of idle funds in commercial paper instead of in call loans. At present so much money often is put out on call that the rate of interest falls to two per cent per annum; while, at other times, there is so little money for loaning in this way that the rate may soar to one-half of one per cent. per day. Abroad, the same sort of funds is put into commercial paper to a very great extent because the paper can be resold whenever it is advisable to resell, the broad discount market thus serving the purpose of our call-loan market. The rate of interest does not change suddenly in Europe, the reason being that a slight advance operates at once as a check upon the production of commercial paper, merchants everywhere watching for changes in the bank rate and varying their own activities accordingly. Here, on the contrary, an advance in the call-money rate merely excites curiosity as to what Wall Street is doing, merchants continuing to buy goods about as usual and relying upon their banks or their

note brokers to find the necessary funds. These are forthcoming until there is a very general scarcity and then comes a crash. The difference of vital importance is the foreign **gradual** hardening of money rates as compared with American **sudden** hardening of money rates.

In Europe, the open discount market and the central banking institution are in close touch at all times and neither could exist well without the other. The great market absorbs the bulk of the commercial paper and prevents an avalanche of it from reaching the central bank. The central bank standing always ready to rediscount paper or to loan money upon securities, the amount of money which it would furnish being practically unlimited, gives stability to the discount market by its assurance against any such mal-adjustment of the money-supply to the money-demand as we know under the name of "currency famine" which, of course, is a misnomer, the more suitable term being, say, currency voraciousness, since it is the appetite for currency which increases and not the quantity of currency which decreases. But although a comparison of European with American financial conditions indicates that we need a central bank as well as a discount market yet a study of American ways and American financial history shows that we can not have any such bank. American politics destroyed the first Bank of the United States in 1811, and the second in 1836. Several years ago a very important commercial body sent an investigating committee abroad and this committee reported in favor of a third experiment, the establishing of a central bank, and then the parent body adopted its committee's re-

port; but, so far as I know, not a single statesman of any prominence has been so lacking in the instinct for his own political preservation as to attempt seriously to create public sentiment in favor of the centralization of banking power and influence, at least under the name of **bank.** The Aldrich Plan is for a national reserve association with branches, and it remains to be seen whether this is too much like a central bank to find favor in the present period of general decentralization and of nation-wide destruction of the ties which bind together the component parts of trusts and amalgamations. From the political standpoint it would seem to be much easier to get congressional favor for the establishing of **many** reserve associations than for the establishing of one great association with many branches. Still I do not wish to be understood as joining with those who claim that the Aldrich Plan was drawn to suit what is, fairly or unfairly, called "The Interests" or "The Money Trust." I attribute to the great senator, as well as to his followers, the most patriotic motives; but nevertheless, I should say that no more inopportune period could have been chosen for offering to the public any creation, however able and ingenious, which bears the name of the champion mixer of politics with tariff schedules. It is inevitable that a mixture of politics and finance should be looked for.

The development of open discount markets and with them of the principles of central banking would proceed more naturally and certainly, in our country of vast and varied interests, if there were established **many** reserve associations, than if there was established

only one with many branches, at least the matter so presents itself to me. People are not going to buy and sell paper with the greatest possible freedom unless there is perfect assurance of the smooth working of all the financial machinery, operating under the central banking idea. There must not be any fear of hitch or delay. Senator Aldrich names Washington as the headquarters of a central reserve system and at once we have difficulty, for New York is the financial centre of the country, and banks and bankers, all over the land would continue to keep balances in New York without regard to any new scheme. Therefore, when a dangerous situation should appear, either the managers of the New York branch would act quickly and without regard for the Washington headquarters or would waste valuable time in explaining matters to Washington officials and getting their advice although these officials would not necessarily be in such intimate touch with financial affairs as to know what advice to give. I should think that the most important assistance in central banking which might be given by such head officials as should be located in Washington, would be the vigorous wielding of an O. K. rubber stamp. On the other hand, it is not likely that the country would consent to the choice of New York for the headquarters of central banking as many persons would think they could see Wall Street domination in that. But if New York, Chicago, St. Louis, New Orleans, Kansas City, San Francisco and other financial centres, possibly more than fifteen, the number named in the Aldrich Plan, should be treated as **separate** reserve centres, no political or

other objection ought to be raised. Also it is reasonable to suppose that future political control of separate reserve associations would be more nearly impossible than of one association with branches, especially if the one should have headquarters in Washington, the country's political centre. And if any unforeseen evil should be found in any separate reserve association it could be easily corrected by the Government while an evil in a great reserve association, ramifying through the whole country, might be too closely associated with an evil of governmental administration itself. The best chance for the development of great discount markets seems to lie in each market having its own reserve association to depend upon in time of need, the managers in each case, being closely in touch with local conditions, understanding the value of local securities and of local commercial paper and standing ready to act quickly and intelligently and with no more consideration for politics than is ever shown by the officers of any one of the clearing house associations throughout our country. The development of such broad discount markets as should command the confidence of European bankers and investors would be of incalculable benefit in giving steadiness to our rates for money. An advance in the discount rate at London now draws funds from Paris or Berlin and an advance in the discount rate at New York ought to draw European funds with almost equal rapidity, now that we have five-day steamships. A great New York Reserve Association would be able to give the necessary assurance to foreign money lenders both as to security against loss and as to the employ-

ment of funds for definite periods, sufficiently long to warrant the expense of their transfer. Between foreign institutions and a New York Reserve Association or other large American associations there could be intercourse by cable without fear on the part of foreigners of American political interference in decisions. There could be swift and wholly business-like action.

Separate reserve associations would have no need for a uniform rate of rediscount or a universal rule as to the securities which might be accepted or the quality of the paper which might be rediscounted. Any uniformity which is suitable for countries of very small area like England, France and Germany might not work well here. In a land of so great extent as our own, securities which are well known in one place might be unknown in another; and at any given time, the same rate of interest, discount or commission might be too high in one place and too low in another. Lately, too, some American bankers have expressed the opinion that some portion of the deposits of a national bank might properly be loaned upon farm mortgages, for a few years at a time, although these deposits are subject to check or draft at sight. Now, surely, if there is to be any practice of this nature, it ought to be confined strictly to the localities which want it and which are willing to pay whatever penalty, if any, the practice may exact.

Monopolistic control of separate reserve associations would be as impossible as it now is of clearing house associations for each member-bank and member-trust-company would have one vote as is now the case in

clearing house associations, no regard being given to the comparative importance of different members.

Separate associations would exchange reports and general courtesies because the governors of all associations would be actuated by a similar motive, that ot steering their respective communities clear of financial disaster. The competition among banks, in seeking business, would have no counterpart among reserve associations, the object of these being the promotion of prosperity and it being evident that any financial obstacle anywhere might make trouble in many places. It would be natural for these associations to help each other even as the Bank of England and the Bank of France help each other. Financial tranquillity in either country is advantageous to both countries.

Each reserve association would act quite as much for the benefit of all its member organizations as does each clearing house association but should act also for the benefit of the community; and, to be able to do this must have the confidence of the community. Therefore, the officers of reserve associations should not be officers of component banks, but the rule of the Bank of England, should be followed in keeping active bankers out of its court of governors, the public thereby counting upon disinterestedness in any action of the central body, no group of financiers being able to get its assistance against any other group or for the purpose of accomplishing any **coup de finance.** Altruism is important in central banking as further shown in the rule of the great English bank, allowing only one vote to a stockholder, not allowing the customary vote per share, for while the

bank must earn dividends it must also serve the country. For instance, it must keep idle a large reserve against the temptation to increase its loans and so earn larger profits. The temptation might be too great if votes per share were allowed.

In the management of the Bank of England too, there is another good point which could be copied by separate associations:—the Government has no voice and as the Government's voice is sometimes only the politicians' voice it is important to note that the officers of **separate** reserve associations would not naturally affiliate with government officials, while the officers at a headquarters in Washington would almost necessarily get some political bias. Finance and politics make an undesirable compound, extremely dangerous under imaginable conditions. Under the Aldrich Plan some government officers have important places although central banking is not a governmental function, properly speaking. The statesman's place should not be to assist in managing but to watch for unfairness in management, in order to expose and correct it.

An association of national scope must have a headquarters; and, while London, Paris or Berlin is the unquestioned place for a central office in England, France or Germany, being the financial centre, in each country, respectively; yet, those who advocate an American **national** reserve association look upon New York, our financial centre, as an impossible place and choose Washington, a city which has no comparative importance in business or finance, and which is objectionable because it is the seat of government and the hot-bed of

political activity. To my mind, the unsuitability of the United States for a national reserve association is indicated also by the fact that nobody takes any interest in the choice of St. Louis, rather than Washington, for the present centre of population is near to St. Louis and may soon be nearer. Still, if we are to look ahead regarding the centre of population we must consider the claims of Kansas City and that city, indeed, has a distinct claim because it is only a short distance from our geographical centre. If, however, we have separate reserve associations each one would have whatever importance may belong to it, now, and would have its own fair chance to grow in importance.

Each reserve association in this country would have sufficient strength for its locality, in the capital and surplus of the institutions composing it, supposing those now in clearing house associations to become members. We should have a New York Reserve Association five times as strong as the Bank of England, the most influential bank in the world, a Chicago Reserve Association of greater strength than that great bank; and, everywhere, we should have associations corresponding in strength to the needs of their communities. The $450,000,000 capital and surplus of the New York Reserve Association, however, would be the sufficient assurance to all banks and bankers, that their New York balances certainly would be shipped to them promptly when ordered and in currency or other form as desired, as hereinafter specifically provided for. Such an absolute assurance would generally prevent the actual ordering of the shipment, for among banks as among custom-

ers of banks, the demand for money grows with the fear of delay or fear of trouble in getting it, any supposed elusiveness in money exciting the grabbing instinct. In this connection it should be noted that the New York financial situation has been greatly improved since the panic of 1907 by the taking of trust companies into the Clearing House Association, for instead of being a menace, they now add to the strength of the great financial body. A New York possible demand for money has been changed to a New York extra supply of money, to help meet the country's demand. And the country's crop-moving demand will not press very heavily upon New York in the future. Factories spring up in great crop-growing states and make an all-the-year demand for both money and banking facilities, large portions of the crops being consumed near their places of production. The alternating eastward and westward tidal waves of currency will become unimportant currents.

The personnel of separate reserve associations in every community would be the very men who best understand financial conditions at all times, the men who are chosen by clearing house associations to act upon loan committees in critical periods. They might almost be named in advance if they would dissociate themselves from other financial duties. And mere personnel may be of incalculable importance at any moment, for banking is somewhat of a psychological science and what is in the public mind or is skilfully put into it, at exactly the right moment, may make people generally leave money in banks, instead of taking it out of banks as otherwise would be the case. In the panic of 1907, it

was not the officials in Washington who knew what to do and how to do it; nor, in the future, is it likely that there would be found any greater ability or greater knowledge at the Washington headquarters of a national reserve association than at the various separate offices of many associations. A difficulty appears in the circumstance that the most desirable men for governor, and deputy governors would be those earning large salaries or having large incomes from their own businesses; but, reserve associations could afford to pay well for freedom from panic or for reliable information and judgment to correct panicky tendencies in advance. And the most desirable financiers would be tempted by positions of the highest honor and the greatest responsibility.

As all the good features of rediscounting and central banking could be put in operation through possibly unobjectionable legislation and by amending certain laws now on the statute books, it would seem to be advisable under present political conditions, to strive for financial reform in this way rather than by the unnecessarily comprehensive Aldrich Plan. To attempt to deal with the national bank note question, for instance, without knowing what to do with the national bonds upon which the notes are based is only to complicate matters. And now that the Government has stopped the issuing of the kind of bonds upon which new notes might be based, the whole note question will grow less and less important as the country's trade grows larger and larger, quite as the greenback question has lost importance through the fixing of the total of greenbacks at $346,000,000, a total which once seemed very big. Then too, no scheme of

currency reform need say anything about gold, for gold will take care of itself in any commerical country which makes this metal the standard of value and which gives gold coins and gold certificates plenty of room in the circulation. With a foreign trade about fifty per cent. larger than our own, and with an enormous "unfavorable balance of trade," so called, England gets and keeps all the gold she needs, simply by limiting the amount of paper money which may be issued, the minor movements of gold being affected by the skill of the governors of the Bank of England and through their changes in the Bank's rate of discount.

We have a law now which provides for emergency currency to be issued to National Currency Associations composed only of national banks and it should not be impossible to extend this law beyond its 1914 expiration and to amend it so as to recognize local reserve associations composed of banks and trust companies. These associations should be incorporated under a new federal law carefully drawn to exactly suit the case and the new money should be engraved in their names instead of in the names of the banks, the government disbursing officers being empowered to take such security and commercial and financial paper as is now provided for and also the guarantee of these reserve associations, the limit of new money for any association being determined by the capital and surplus of such association. Of course, the Government should be as absolutely secured against loss as it is under the present law and while there must be much more certainty than there is now that the emergency money would come out instantly and without

even a chance of possible delay, yet an apparently contradictory point must be well covered also; the emergency money **must not come out** unless there is a real emergency. In England, it has been learned by experience that there is no need for emergency money (which over there means the suspension of the Bank Act of 1844) until the rate of discount rises to 10% @ 12% and until this high rate shall have induced an inward flow of gold; and, as a 10% rate is sufficient to bring gold "out of the ground," there has been no suspension of the Act in half a century, as before remarked. Admitting, of course, that any rate of discount or interest which would be high enough in England might not be high enough in America, yet we must see that the English principle of increasing the rate for money, in order to cause a reduction in the demand for it, is scientifically correct. Certainly it could be followed here if we pay sufficient attention to American conditions. In each of our separate reserve associations, the financiers in charge would have both local and general circumstances in mind and if unhampered by unnecessary rules would develop the skill of Bank of England governors. It would not take very long to learn that if new money should come out too cheaply it might serve only to heighten speculative fever or to increase the exportation of gold, while, on the other hand, if a large amount of new money is not in sight people will hoard what they have. The tremendous importance of the personnel in central banking is apparent if we consider all the effects of changing the rate of discount or interest. The highest order of sagacity and disinterestedness may be secured

for the management of independent reserve associations, just as it is now for the committees of clearing house associations, but it is unlikely that our best financiers would be ready always to act under the instructions of men at any headquarters, however selected or if appointed by the President, for sometimes in the past it has happened that even secretaries of the Treasury have been appointed more on account of political influence than on account of financial skilfulness. In New York, and I presume elsewhere, the highest order of financial talent would claim the most implicit trust and reliance on the part of everybody concerned and would stand no outside guidance or interference.

The cost of new or emergency money would be high because the Government should be compensated for its expense and because the reserve associations should be paid for their guarantee. Graduating rates of three, four and five per cent. per annum would seem to be fair for the Government, the rate increasing as an association increased its takings of its allotment, and the charge to run from the date of issue to the date of return of the new money, or the date of deposit of other money instead, for the identical money might not find its way back. The charge of a reserve association to one of its components should depend upon circumstances; and in a critical time might vary from day to day, the changes being ordered in accordance with a swiftly changing situation. While the Government's charge should be fixed and the duties of every government disbursing officer be accurately defined by law so as to leave no opportunity for judgment on his part, such officer

not necessarily possessing any, yet the widest possible latitude should be given to the chosen heads of a reserve association, these persons being selected for the very reason that they would know best what to do in an emergency. At one time, they might simply state that an expert and disinterested investigation had shown the soundness of a certain institution; at another they might put the association's endorsement upon a bank's paper for a small fee; at another, they might take over two or three banks' assets and put cash in their place to meet a run of customers, and, here again the charge would be low if there were no ultimate risk; but, at still another time, or if there should be continued financial disturbance after ordinary action had proved to be ineffectual, then the guaranteeing or rediscounting charges should grow heavier, making the process correspond to the well-proved Bank of England methods, the greater and greater cost of new money inducing everybody to get along without it so far as possible. Panics are not uncontrollable because of a high rate of discount or interest, this expense being merely for short periods. In New York there could be no panic if people knew that $450,000,000 were instantly available no matter what the expense of getting it. And with a secure feeling at the financial centre there would be no feeling of insecurity anywhere even without any other reserve associations although it would be as well to have them. For instance, the Chicagoans would enjoy feeling that $100,000,000 of emergency money was available for them at a moment's notice. Banks and bankers are not entitled to a supply of cheap money, whenever they ask for it, for

that spells inflation but they are entitled to the assurance of being able to get new money when they are willing to suffer a penalty for their over-confidence or for the over-trading of their customers. Merchants have to pay fire insurance premiums all the time and bankers should not object to an assurance charge once in a while. Nobody is exempt from the danger of losses to come from the carelessness of others.

Some bankers and some merchants object to any tax upon emergency money, the merchants, especially, wanting low interest rates, all the time. But is it not plain, if an abundance of new money could have been got in 1905 and 1906, **without additional expense,** that prices would have been carried higher; that speculation would have exceeded much further the bounds of prudence; and, that the crash of 1907 would have been still more disastrous than it actually was? Financial history says this, I am sure. And interest rates could not have been kept down, for always and everywhere, high interest rates belong to periods of active trade and speculation. Perhaps it may be some consolation to merchants who want low interest rates, to reflect that low interest rates go with low rates of profit. Lenders of money in old and comparatively non-progressive commercial countries, take little risk and get little compensation. In these same countries, there may be found low rents and low wages. Better be satisfied with those American progressive activities which make rents, wages and profits high, while giving a fair share of the general income to the individuals who keep capital to lend and who thus help along the general prosperity.

It seems advisable that each reserve association should have a working capital, each member, bank or trust company being permitted by law to contribute a definite portion of its own reserve. The keeping of a certain percentage of deposits as a reserve belongs to unscientific banking, the approved way being to concentrate the reserve and then to let the highest order of financial ability decide how large it shall be, the magnitude of the reserve changing with the pulsations of trade and finance but the master minds always watching the reserve and all the influences which affect it. In England, no bank is obliged to tell what portion of its reserve is in its vaults and what portion stands to its credit at the Bank of England. The business men of New York would enjoy greater financial security if, say, $100,000,000 were taken from individual bank reserves and placed in the vaults of a New York Reserve Association, to be used without question or interference, whenever the officers in charge should desire to use it, partly or wholly, for what they considered to be the interests of everybody in the community, not only the interests of banks, in a narrow view. In other centres the working capital would be proportionally less but I believe that everywhere there would be sufficient concentration of available cash in the hands of expert and disinterested persons, to overcome the ordinary financial disturbances without resort to the emergency money in the hands of government disbursing officers. Each reserve association might decide for itself what portion of a bank's reserve should be contributed for general use and benefit. Isolated banks feel the need for cash in hand more strongly than

do banks which have many close and friendly neighbors. The advantage of prompt action in finance is sometimes the same as that of prompt action in small fires. We fully recognize that a very little fire may grow into a conflagration and some time we shall learn that almost any financial disturbance can be so skilfully treated as narrowly to limit its influence. Something of the sort happens now when great banks or bankers cure the "sore spots" on the financial body, by substituting cash for other assets but such work as this should never result directly to the benefit of individual banks or bankers—the whole community's benefit should always be the sole consideration. It may fit the case to say that we need a Financial Board of Health.

Early in 1908 the writer had the honor of appearing before the Banking & Currency Committee of the House of Representatives in advocacy of the development of the duties and privileges of clearing house associations and of a plan for depending upon them for general financial reform. In the light of further study and reflection, assisted by the publications of the National Monetary Commission, this present plan has been evolved and is now offered but with no thought that it may not easily be improved or that important errors may not be pointed out. Critics may say that a better plan would have been offered if French, German and other experiences in central banking, as well as English experience had been drawn upon, but a fair answer would seem to be that those experiences might prove to be misfits when brought to America: The French, because a large portion of French business is done with money

rather than checks, French bankers not yet drawing all the little hoards of money into their tills; the German because we could not tolerate in America the meddlesomeness of the officials which people are used to in Germany; and the financial experience in other countries than England is unimportant because of every other country's lack of a vast internal and external trade. English finance on the contrary on account of its extreme fineness of development and because it has proved suitable to a people used to a great volume of trade and who care as much for individual liberty of action as we ourselves care, may well be drawn upon for our guidance, yet with the fullest recognition that American business, American politics and American life have their own distinctive characteristics.

Let us now take a new and a broader view of the subject of financial reform. We need immunity from nation-sweeping hallucinations as well as from acute monetary crises. Our people always have had a mania for a plentiful supply of money and generally have been careless about the quality of it although at the time of the founding of our Government, more than two centuries already had elapsed since Sir Thomas Gresham made the discovery that a superior quality of money would be driven out of circulation in any country, by an inferior quality, unless the latter were limited in amount. It is not true that Americans know less than other people about monetary science but it is true that Americans have need for greater knowledge. It seems not to have occurred to our statesmen, financiers and educators that we vote almost directly upon financial questions and that we ought to be

taught how to vote upon them. It is disgraceful that so late as the end of the nineteenth century, our financial quacks were able to find more patients than our medical quacks. No sound-money campaign against bi-metallism and against free-silver-coinage would have been necessary if our people had been properly instructed in school and college, but it is nevertheless a fact that both houses of congress swallowed the nostrums of the quacks. Money has been the thing which everybody wanted and nobody understood and even now there is no certainty that the coming generation will be very much better informed than the generation which nearly wrecked our national honor.

If, too, we consider the banks rather than the money, we find a corresponding popular misapprehension. In the first half of our national life, banks were tolerated as necessary evils; in the second half, we commonly think of them, only as contrivances of the rich, for adding to their riches. It is possible for a boy to get through school and college without learning a great deal about the difference between a toy savings bank and the savings-bank on the street-corner, and there are numberless well-educated people, as education goes, who do not understand the services which are rendered by the banks of discount and deposit. There has been, always, a generous feeling for borrowers, often expressed in legislation but legislation is not apt to favor the banks, although they are borrowers as truly as they are lenders. And the banks are entitled to especial consideration for borrowing only the money which nobody can use and lending it to the individuals who are able to use it. By

the necromancy of banks, the money which you do not want now but may want, at any moment, is given greater facility for use by yourself, through your check-book, and is placed at the disposal, also, of somebody else, the usefulness of your money being nearly or quite doubled. The total of bank-deposits is near enough to the total of bank-loans to warrant this statement, the reserves of the banks being largely the capital and surplus which belongs to the stockholders. In modern trade and industry, the banks have become the indispensable lubricators of the whole machinery; and, the workman who knows that his little machine would "freeze solid" if not supplied with oil or grease, ought to have been taught before leaving school why factories have to stop running when the work of the banks is disturbed. Workmen are ready to ask for legislation for their own benefit and might be shown not only that banks are their best friends but that banks earn dividends exactly as workmen earn wages, workmen giving useful employment to idle faculties and banks giving useful employment to idle funds.

There can be no question of the desirability of general enlightenment in a land of universal suffrage but any suggestion of means to the end is a proper subject of controversy. And, naturally, criticism must be expected for the new idea that **separate** reserve associations could be used in an educative way. It is significant, however, that education in America depends upon **separate** schools and **separate** colleges and therefore it will not do to assume that no connection of any sort can possibly be established between our educators and the officers of

separate reserve associations. At present, financiers may take little or no interest in the curriculum of any school but this does not prove that they never will take much interest, for against such a supposition may be placed the fact that men of large affairs do serve upon Boards of Education. Financiers are as public-spirited as other busy men but no way has been open for them to aid our educators. And, too, there is a prejudice against men who are successful in finance. Doubtless also there are localities where socialism has gained control of some teachers and professors and these persons would be suspicious of anything coming from bank officers, for bank officers belong to the conservative class. Difficulties will be found in the way of showing our youth what they ought to be shown of rudimentary financial principles but if they are not shown, then there must continue to grow the power of that sort of political capital which sometime will measure its strength against financial capital. However, the cause of education is not hopeless for if we establish separate reserve associations, we should have as their governors men who know all about financial subjects and yet who are dissociated from financial institutions and therefore outside of the struggle for wealth. In any locality, a governor of a reserve association, he having a suitable reputation, could make it known that the welfare of the banks is bound up in the welfare of the people; and, in due time, he could get put into text-books or at least into the syllabuses for teachers enough to make a beginning in financial instruction. A good governor of a reserve association would be willing not only to do his best for his association in his

own time, but to help his association in the future, and he would see that education is an important ally in preserving that financial orderliness under which trade and industry make their greatest progress. Education in finance is like education in other matters; knowledge creates thirst for more knowledge. A youth to whom is explained the intrinsic value of gold money and the promissory character of other money, will be likely to learn, before he is able to vote, what it is which gives full purchasing power to bits of paper; and, as the chances are ten to one that he will be a wage-earner and not a wage-payer, he will be ready to vote to receive only that money which is as good as gold. A youth who is taught something about the work of banks of discount and deposit, at the time he is taught "Interest and Bank Discount", may have his curiosity excited to learn more on the subject and by the time he is able to vote may have a good appreciation of banks as public servants, and not be willing to listen to demagogues who, for their own ends, would harass the banks as well as other institutions of civilization. A reserve association as a Financial Board of Health would not overlook the rapidity with which young people become factors for good or ill. The advantage which separate reserve associations, as educators, would have over a national association will be apparent if we look back on the silver lunacy. Congressmen went crazy and if there had been a national reserve association, at Washington, the officers would have been divided among themselves. Bi-metallism might have been given a favorable word in school-books with the result that our present-day voters would have

the trouble of unlearning much of what they were taught when students. As a source of information upon any subject which has been or may be a political question, a national association is liable to be a failure or an instrument for harm. To illustrate this point we may fancy any national association attempting to teach the principles of taxation and trying to be non-partisan between the advocacy of revenue duties and the advocacy of high protection. While it should not be denied that some one of all the separate reserve associations might help to spread a heresy yet it is certainly true that the lack of authority of any one over the others would limit the injury, in both extent and duration. Competition among separate reserve associations to promote enlightenment on the principles of money and finance would be started by the most enterprising association actually getting some of the simplest axioms put into some school books. Another association, learning of this, would be able to make an improvement of some sort; and, thereafter, no backward step would be possible. The separate reserve associations of our country in the course of natural progress, would become the recognized sources of information and our educators would be supplied with what they have lacked hitherto, fountains of financial truths, unpoisoned by the suspicion of either politics or selfish interest. We cannot say what may be the form of the next financial insanity to afflict the American people but we may be sure that education is the only preventive of the affliction, whatever its peculiarities may prove to be.

There is good reason for leaving to the future, the co-ordinating of our various kinds of paper money, although we have greenbacks which ought to have been retired long ago, silver certificates which never should have been issued, national bank notes which slightly increase or decrease in volume, when they should do the reverse; and, although we have gold certificates which represent an ever increasing hoard of gold in the Treasury. The incongruity is not picturesque but we may do well to notice that the greenbacks and the silver certificates do not increase; that the increase in national bank notes, in a whole year to October 1, 1911, has been only $5,734,040 or less than one per cent of the total of such notes; and that the increase in the volume of gold certificates may be looked upon with equanimity, at least by everybody who took part in any of the struggles for sound money which began soon after the Civil War and had to be continued to the victory of 1896. There are no terrors in contemplating the fact that the volume of gold certificates, in circulation, has grown in a single year from $845,965,959 to $930,126,029; and I see only satisfaction in the estimation that gold coins and gold certificates now make up about forty-seven per cent of the total circulation, whereas, at the time of the resumption of specie payments in 1879, these moneys amounted to only about fourteen per cent of the total. The process of increasing the percentage of gold money to all money is likely to continue unless we interfere by new legislation; and, it is nearly certain that legislation, if effective in putting new paper money into circulation, would merely substitute such new money for gold or gold cer-

tificates. It is hardly within the ordinary power of law to increase the whole circulating medium but well within its power to drive gold out of the country. It is estimated that we have $3,242,182,715, total circulation, and I am afraid that some people reason that the gold portion, $1,525,260,488, should give us a total circulation of about $6,000,000,000, instead of only $3,242,182,715. It is easy to demonstrate however, that the $34.35 per capita which suits us at the present time would suit us as well under different laws. In other words, if by any banking arrangement, in operation during the past decade or two we had come into the use of a circulation consisting of only one-quarter gold, the difference would be the present European possession of over $700,000,000, gold, instead of the present American possession of this sum. We should have exported this amount of gold, and, as an offset, our exportation of merchandise and securities would have been somewhat less than they have been and our importations of goods somewhat greater. And in the future, economy in the use of gold must have a similar effect, merely the substitution of paper for gold and the releasing of gold for exportation. I should think it much better to go on accumulating the metal even if for no other reason than the comfortable assurance of being strong enough, monetarily, to keep upon the gold basis through any great war, instead of slipping off to the paper basis, as in 1861.

I see no advantage in hurrying to decide whether new paper money shall be issued by one association or by many associations or by either, the requirement of elasticity in our volume of paper being satisfied by the

provision for emergency money, to come out when needed, and, to go back when not needed. We are growing in wealth and population and if we continue to accumulate gold we shall gain ground for hoping to become the world's financial centre. With the annual production of gold increasing and with the American production up to about $100,000,000 worth from which we can take about $70,000,000, per annum, for use as money, it is folly for us to try to estimate how little we can get along with. If gold production goes on increasing, we might, sometime in the future, redeem all our paper, excepting gold certificates; while, on the other hand, if gold production should decrease, we should not be compelled to join in a new "scramble for gold" that would soon develop.

Returning, now, to the main subject of this pamphlet, let us note that to establish a **national** association with branches, as proposed by Senator Aldrich, or to establish **separate** associations, as herein proposed, is to make an experiment; and, this experiment involves a new use of finance, the most subtle, pervasive and powerful of all the forces of modern life. In arranging to use a force which no potentate may ignore and which every government must consider before beginning either constructive or destructive operations, caution seems to be in order. Mistakes will be made and will have to be corrected in case either proposition be adopted; but, in one case, mistakes may be rectified easily, while in the other they might be very serious and very difficult to overcome. A **national** association, with some presidential appointees; with the privilege of receiving the

Government's money; and, with the duties and advantages pertaining to the financial agency of the Government, would have power which the country, later on, might have good reason for wishing to withdraw. Now the withdrawal of power or privilege, once given, is sure to be difficult because those who enjoy it are in position actually to use their power or privilege in the effort to keep it. Witness the difficulty of lowering any rate of duty, in any tariff schedule, and how the need for reducing the duty on any article really increases the difficulty in the way of reduction. If, however, errors should be made in establishing **separate** reserve associations, the Government would be free to correct them. The point of the matter may be put this way: if we should establish a **national** association with branches and should find out, upon trial, that we ought instead to have established **separate** associations, great obstacles would be found in the way of dissolution; while, on the contrary, if we should establish **separate** associations, it would be comparatively easy to bring about their amalgamation, should the people so desire. The charters of **separate** reserve associations could be revocable by act of congress; whereas, the charter of the **national** association, under the Aldrich Plan, is to be given a life of fifty years! Twenty years was the allotted life of the charters of the first and the second Banks of the United States; and, neither bank was able to get authority to live any longer although each bank begged for it. There was no question of solvency: the people found out that they did not want a financial institution of national scope.

The extraordinary skill of Senator Aldrich in balancing against each other, the power of finance and the power of politics, leads one to ask if these powers will, necessarily, remain so nicely balanced. Considering the temper of the present Congress, is there any chance, whatever, that a measure with the Aldrich stamp upon it, could go through both houses without amendment? How often do any bills of any kind become law without amendment? And what is more natural than to expect in this case, an upsetting of the nicely adjusted balance of powers? I should think it quite likely, for instance, that as Senator Aldrich puts presidential power and influence into central banking, the Congress will consider it proper to favor its own branch of government and give controlling influence to the Finance Committee of the Senate and the Banking and Currency Committee of the House. Every bill is subject to amendment in its course through congress; but a bill to establish **separate** reserve associations would not be greatly harmed by amendment, because in its original form all power would be left in the hands of the Government, no skillful balancing being attempted. And, too, even if a satisfactory bill should be passed establishing a national association, with finance and politics accurately balanced, we should still have to expect that in actual operation the balance would be upset in our country of rapid growth and marvellous changes. Financiers may have political aspirations and politicians financial hopes. The safe course is to keep the Government's power wholly unconnected with and wholly above the power of finance. In this way the Government retains its supervisory and cor-

rective control. It is not without reason that the English Government has no voice in the management of the Bank of England, and that the positions of principal and agent are carefully preserved. It is because, in banking, there is no suitable place for any government officers. This is the verdict of two centuries' experience.

To attempt to push the Aldrich Plan through this winter is to run the risk of its being amended far out of its original features, because Congress already is engaged in hunting down "Payne-Aldrich-tariff-iniquities" and is not in the humor to look favorably upon Aldrich currency ideas. On the other hand, to postpone action is, in my judgment, to give the people sufficient time to find out that the Plan does not fit the American situation. It means little that important financial and commercial organizations have endorsed the Plan, for, in most instances, I think, endorsement is merely the acceptance of committees' reports. In the case of one of our most influential organizations, the members attending the meeting which voted the endorsement, voted down a motion for a show of hands, as to how many of the persons present had even read the Aldrich Plan! The supposition that the Plan might possibly have been read by many persons, was treated as a joke .

Considering the shortness of the time that any plan for financial reform has been so placed before the American people, as to lead to general discussion it would seem advisable not to attempt this winter, anything more than the amending of the National Bank Act, leaving more radical action until after the presidential election of 1912. A fair start toward the development of

open discount markets for financial and commercial paper could be made by giving permission to banks to place their acceptances upon time bills, not only upon bills "arising from commercial transactions" for this restriction might have the absurd effect of preventing a bank's giving its acceptance when the paper is most perfectly secured, that is by easily marketable collateral. The proper restriction relates solely to extent of risk, in any one direction, say, for instance, to 10% of a bank's capital and surplus and with short time limitation. A second amendment of the Act, should be the granting of permission to banks to count as legal reserve clearing house loan certificates, to the extent of one-half of the required reserve. No money has ever been lost by the use of these certificates; and, the security back of them makes it impossible to see how any money ever could be lost by them. The effect of this amendment, applying it to banks of the central reserve cities would be to release in time of stress, over $200,000,000, a sum considerably larger than the total of certificates issued in these cities in 1907. Loan certificates come out only in panicky times and never stay out very long. The knowledge that they could be counted as reserve would make banks more generous in loaning in the earliest critical moments and thus helping to ward off panic. These changes in the Bank Act would give the country the benefit of another year's study of our unparalleled financial problem and make more probable the chance of a true solution. It might appear a year or so hence, that the Aldrich machinery is unnecessarily ponderous for the correction of a panic, and far too ponderous for

the development here of that manipulative financial skill which, in Europe, has proved to be capable of warding off panics. I should think too, that these amendments to the Bank Act might bring about important changes in the monetary problem itself and greatly simplify it. It would be very advantageous both to have a simpler problem to solve and to know better how to solve it. Financial reform concerns everybody from the capitalists and merchants who want safety and profit, to the laborers who want steady employment. Congress should take a preliminary step, at once; and then should allow time to be taken by the people, to more fully and more generally comprehend the whole financial question, the advocates of any plan of financial reform taking the chance of its survival, as the best in the interest of the commonwealth. Unbusinesslike nervousness might weakly excuse but nothing could justify any haste to make a fifty-year experiment in a matter of transcendent importance to ninety millions of people.

New York, November, 1911.

EXTRACTS FROM REVIEWS

OF

MONEY, SILVER AND FINANCE.

A Book by the Same Author.

(New York World.)

His claim is clearly sustained by his comprehensive argument.

(New York Herald.)

Mr. J. Howard Cowperthwait has put into small space and plain language the conclusions of the business world as to some subjects which politicians and charlatans have wrangled over for the last few years.

(New York Morning Journal.)

It is an excellent book of the sort that a man of ordinary mentality may read without confusion, yet showing a thorough understanding of economic laws.

(New York Times.)

It is a very valuable book. We know of none which is so well calculated to make the general truths of finance plain to business men, or their detailed but constant application to business intelligible to students who are not business men. . . . The author's facts and arguments march with the steady regularity and force of a well-directed military column.

(New York Tribune.)

Mr. Cowperthwait has the tremendous advantage over most reasoners on the silver question that he knows something about practical business, its methods and necessities.

(New York Observer.)

It is a common-sense argument. . . . We hope it will be widely read.

(The New York Daily Stockholder.)

It possesses the elements necessary to make converts to sound-money principles of those who are undecided in their views.

(Wall Street Journal.)

The author treats a wide variety of topics from the standpoint of a gold advocate, but with a liberality which permits him to quote freely from opposing views.

(Sunday Democrat.)

It is a pity that he is not in Congress, for he has a faculty of making the most abstruse point in finance clear and interesting. . . . The best work that has yet appeared on the subject.

(The Examiner.)

He does his work well. As a business man, he knows and makes clear what would be the effect of free coinage of silver; and he has so far mastered the literature of finance as to make his book profitable reading even to those who are fairly well informed on the subject already.

(Engineering and Mining Journal.)

His style is very engaging, and the book holds the interest of the reader from first to last. The chapters on the balance of trade, foreign exchange, and the debtor class, are especially good.

(Scientific American.)

Such a writer has evidently the courage of his convictions, and such a quality is a commendation of his book.

(American Banker.)

Mr. Cowperthwait has had ample opportunity, coupled with ability and application, to study the silver question and kindred financial problems which have so puzzled the law-maker. The book in question is a carefully condensed treatise which throws much light into the dark corners of the finance labyrinth.

(Independent.)

The author writes as a business man, and states with much force and sufficient argument the case against the free coinage of silver by our Government.

(The Congregationalist.)

We heartily agree with him, and commend his treatise.

(Outing.)

Whether or no the reader is convinced, he will certainly profit by the author's labors.

(University Magazine.)

His chapter treating of the foreign exchanges shows wide and intelligent acquaintance with fact. The book, although eminently opposed to the "free silver" movement, is, in its matter and argument, of such intrinsic value as to be well worthy the careful perusal of all interested in the subject.

(New York Morning Advertiser.)

The book in question is a carefully condensed treatise which throws much light into the dark corners of the finance labyrinth. Prices, wages, bi-metallism, the free coinage of legal tender silver, international exchange, the balance of trade, the volume-of-money theory, and a dozen allied chapters, are handled in an exhaustive manner. Every student of finance should have the book upon his desk.

(New York Evening Telegram.)

The opinion fully expressed of a business man upon a question which politicians are ignorantly playing with.

(New York Press.)

A thoughtful and comprehensive survey of the present financial condition of the United States. . . . A timely and helpful contribution to the economic literature of the day.

(New York Commercial Advertiser.)

Mr. Cowperthwait's treatise is clearly written and his argument well put.

(New York Journal of Commerce.)

The book contains an interesting history and discussion, accompanied by tables, of the movement of prices, the relation of prices to wages, the balance of trade and foreign exchange, the "volume of money theory," and allied subjects.

(Brooklyn Eagle.)

It is evidently the result of wide reading, much reflection, and accurate observation, supplemented by practical business experience. . . . It deserves the respectful consideration of all business men.

(Brooklyn Standard-Union.)

Col. Cowperthwait's book will do much valuable service in the cause of honesty and honest money, and is most timely. It is concise, with the directness and precision of a business man.

(Brooklyn Citizen.)

It certainly covers the ground in a comprehensive way.

(Brooklyn Life.)

Col. Cowperthwait's illustrations are excellent. . . . He succeeds admirably; the argument is clear and logical, brief, and to the point.

(Norwich Bulletin.)

The subject is so plainly and comprehensively handled that any man of ordinary intelligence can grasp it.

(Bedford, Mass., Standard.)

It is a common sense book, and will be widely read.

(Yale Courant.)

The lucidity of the argument and the broad treatment of the question by the author, make the work worthy of perusal and of careful thought by those who have no well-defined idea of why they are opposed to silver legislation.

(New Haven Palladium.)

The book contains a great deal of valuable information on the subject.

(Providence Journal.)

With remarkable compactness, clearness and precision of style, he manages, within 230 pages of large print, to make the general truths of the principles of currency perfectly plain to the average degree of intelligence, and to say about all that need be said on the silver question from the purely national point of view.

(Springfield, Mass., Journal.)

The chapters on the balance of trade and foreign exchange are of special interest.

(Worcester, Mass., Gazette.)

A clear and intelligent explanation of many of the points which the country is now discussing.

(Boston Journal.)

No better presentation of the present condition of the silver question has yet been published; . . . an argument that is instructive, intelligent, and so cleverly stated that those best informed in the subtleties of finance can follow it with continued interest.

(Evening Journal.)

Mr. Cowperthwait's book ought to prove materially useful in the present campaign of education upon this important subject.

(Boston Advertiser.)

The author's style is simple and direct. . . . The first characteristic of Mr. Cowperthwait's book, however, is readableness. . . . The highest praise that can be accorded this book is that it is thoroughly sound, and that there is not an uninteresting word in it.

(Boston Globe.)

In the volume is given the detail of what might be termed a running fight with Senator Stewart and others on the money question, and the reader, of whatever opinion, can praise the author for the fairness with which he states his opponents' case, or allows them to state it, which is better still.

(Portland, Me., Transcript.)

Mr. Cowperthwait's business experience enables him to throw much light on the subject of wages, prices, bi-metallism, international exchange, balance of trade, and many other allied topics.

(Portland, Me., Argus.)

The style is clear, transparent, remarkably free from technicalities, and in general gives token that the writer is both a thoughtful and studious investigator, and a rhetorician of no mean abilities.

(Lewiston, Me., Journal.)

He presents his arguments in a clear and logical manner. The work is evidently the result of much reading and observation, and is not devoted to theories, but to practical ideas.

(Philadelphia Item.)

When people speak about money, the listeners know what that word means, and when people read Mr. Cowperthwait's book they will, no doubt, have a greater insight into the finances of this great country than ever before. . . . The book is a comprehensive one, and probably the best work of its kind yet published. There have been plenty of essays bearing upon the subject of money, but none, the reviewer believes, covers the ground so thoroughly as does Mr. Cowperthwait's.

(Philadelphia Record.)

Lucidity, cogency, and logic mark every line which he has written, and there is not one page that is not bright with example and illustration, presented, too, in such a simple and convincing way that the veriest tyro in political economy can follow his reasoning and comprehend his conclusions.

(Philadelphia Bulletin.)

The author is a practical business man, and he makes a very strong argument against free coinage, based on an education in business.

(Philadelphia Stockholder.)

We think every business man interested in the questions of the day, and particularly in that burning one, the silver question, will be amply repaid for the time expended in reading "Money, Silver, and Finance." Mr. Cowperthwait is himself, a business man, and he takes the direct method of a business man in going straight to the heart of his subject, which he treats in a masterly way.

(Philadelphia Press.)

The author's discussion is exhaustive. He writes for the average reader, and writes very clearly, in particular of India and her silver rupee, of prices and wages, and foreign exchange.

(Philadelphia Public Ledger.)

Cool in his reasoning, staid in speech, the writer produces a most favorable impression by his judicious and well-considered essay.

(Pittsburgh Chronicle-Telegraph.)

The author is especially clear in stating the reason why China and India, which had been for centuries absorbing all the silver of the world, have stopped doing so now.

(Baltimore Sun.)

It is a very able presentation of this side of the problem.

(Baltimore American.)

Every line bears testimony to the careful deliberation with which the author has proceeded to collect his material, and evidences the fact that he knows whereof he writes.

(Washington Post.)

It is one of the ablest contributions to that side of the question which has ever appeared.

(Richmond, Va., Times.)

A strong argument against the free coinage of silver, written by a business man.

(Buffalo Express.)

Mr. Cowperthwait's arguments are short and to the point, answering the free-coinage fallacies one after another. There is not an uninteresting page in the book.

(Mercantile Review.)

The chapters devoted to a description of the action of foreign exchange are as good as any we have seen, and in several important particulars clearly put and quite new to the average student of money matters.

(Buffalo Times.)

He makes a very strong argument against free coinage, based on an education in business.

(Cincinnati Gazette.)

The style is plain English. Students of these live questions will find valuable help in this work, especially as a compendium of the history of silver legislation and silver money in this country.

(Ohio State Journal.)

He clearly and satisfactorily exposes the silver fallacy in the light of both principle and experience.

(Indianapolis Journal.)

The author's views are intelligent, conservative, and well expressed, being on the side of sound finance and honest money.

(Lafayette, Ind., Leader.)

His keen, sarcastic criticism of his opponents' beliefs must be appreciated even by men voting in direct opposition to his views.

(Peoria, Ill., Transcript.)

He has considered his subject from a business man's standpoint, and in such a way that he may readily be followed by those who have not previously made a study of the subject.

(Chicago Herald.)

This is an excellent and timely discussion of the silver question.

(Chicago Times.)

The most compact, lucid, and convincing exposition of the nature and workings of foreign exchange ever offered to the public; . . . furnishes another and very clever analysis of the volume-of-money theory.

(Chicago Tribune.)

Mr. Cowperthwait's book will do more than the temporary service of enlightening the public in regard to its duties respecting the free-silver fight of the present Congress. It can impart information which is very much needed.